ElectraNet SA

Transend Revenue Cap
Draft Decision

Public Forum

17 October 2003

Purpose of Presentation

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- To highlight a number of concerns raised by the ACCC's draft decision
  - Asset valuation
  - Capex including alternative approach
  - Opex
  - Cost of capital
- NOT to comment on the appropriateness or otherwise of Transend's revenue cap

Asset Valuation

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- Draft Decision adopts the jurisdictional asset valuation but expresses concerns about this valuation
  - Easement compensation costs (landowner costs)
  - Easement acquisition costs (route selection, survey, environmental approvals, legal costs)
  - Interest During Construction
- These are legitimate costs and must be appropriately recognised in the regulated asset base for TNSPs to recoup and earn a fair and reasonable return on their investments

Asset Valuation

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- It is appropriate that these costs are recognised in Transend's asset base as they should be in all others
- "*The ACCC considers that easements should be valued at actual historical costs adjusted for inflation... The ACCC used this approach in its last two revenue cap decisions, for the South Australian and Victorian transmission networks*" (Draft Decision p26)
- Correction – In the South Australian case easement compensation costs were not valued at actual cost adjusted for inflation and easement acquisition costs were omitted altogether

Asset Valuation

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Network	Fixed Assets $m *	Circuit length (circuit km)	Easements $m *
ElectraNet	820.4	5,600	3.4
SPI PowerNet	1,741.1	6,500	94.5
Powerlink	2,101.9	11,200	174.9
TransGrid	1,533.0	12,400	402.0
Transend	474.0	3,500	48.0

* Source ACCC

Asset Valuation

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- Draft Decision goes on to say "*In both cases, the ACCC did not allow easement acquisitions costs*"
- However, these cost should be allowed
- The ACCC's Regulatory Principles must appropriately treat the valuation of easements
  - Easement acquisition costs have generally not been included in transmission line valuations as has been claimed by some and must be recognised in the asset base

Asset Valuation

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- Easement acquisition costs are appropriately valued on a replacement cost basis – they are unrelated to land values
- Support proposed benchmark approach for easement compensation where historical cost records are unavailable (if ACCC insists on adopting historic cost approach)

Capital Expenditure

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- Support the statement that "*the challenge is not to repeat historic levels of capex, but rather to meet the future requirements of the system*" (Draft Decision p40)
- Capex cannot be sensibly benchmarked between networks or with historical levels of expenditure
  - lumpy nature of capex
  - primary drivers for capex are load growth and service standard obligations – these must be met irrespective of capex comparisons

Capital Expenditure and Demand

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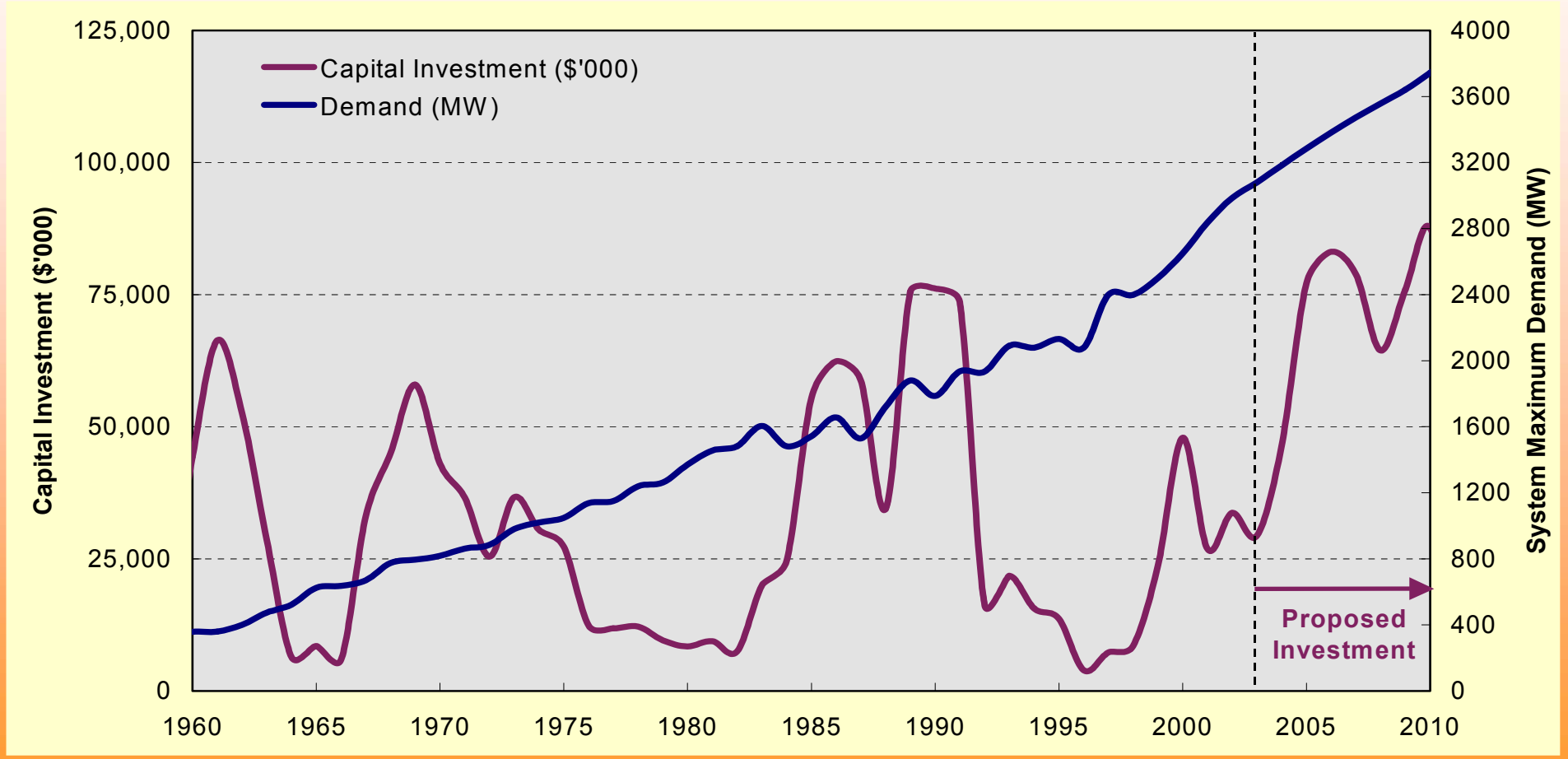
Example: South Australia



Alternative Approach to Capex

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- ACCC has proposed a more light-handed regulatory approach for non-contestable capex funded by individual network users
- For example this would include prescribed connection assets and funded network augmentations
- Costs would be excluded from the capex allowance but allowed as a pass through
- Support a more light handed regulatory approach, but how would this work? What does the ACCC mean by pass through in this case?

Alternative Approach to Capex

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- Would new customer funded capex projects effectively be treated outside of the revenue cap and priced separately?
- Treatment outside of the revenue cap and separate pricing would appear to be preferable to a pass through under the revenue cap – e.g. EPO arrangements in South Australia
- Approach would need to be supported by appropriate contractual arrangements with transmission customers
- If proposal is to be considered further this should be done as part of the Draft Regulatory Principles review

Operating Expenditure

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- "*The ACCC's DRP foreshadows that it will consider the use of an incentive mechanism where a TNSP is able to demonstrate management induced efficiencies*" (Draft Decision p65)
- The ACCC's preferred position in the current review of the Draft Regulatory Principles is for a more light handed approach that strengthens incentives for opex efficiencies
- Application of an "efficiency factor" to cut the base opex appears heavy handed and inconsistent with the ACCC's preferred position – especially given that base opex has already been cut below what was assessed as necessary

Cost of Capital

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- Draft Decision sends very negative signals to investors – ignores appropriate high-level policy and the timely "wake-up call" from recent US and other overseas blackouts
- Regulated rate of return is only a small margin above the risk-free rate
- ACCC has signalled a preference for using market data to determine the equity beta – data that is acknowledged as being presently unreliable – suggesting a 25% reduction in the margin above the risk free rate

Cost of Capital

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- Simply floating this idea significantly increases uncertainty and regulatory risk for investors – big negative impact on investment
- In contrast the US is recognising the importance of a reliable transmission grid and is taking steps to attract more investment through higher rates of return
- Recent survey "International Comparison of WACC Decisions (a submission to the Productivity Commission review of the Gas Access Regime) shows regulated rates of return in the US are already substantially more generous to investors than those in Australia

Important Perspective

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"Society's true interest does not involve the lowest possible electricity rate. The public's interest lies in completely reliable electricity produced at reasonable prices. There is a difference"

Robert Samuelson, Washington Post